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GENERAL SERVICES ADMINISTRATION

Overestimation of Federal Buildings Fund Rental Revenue Projections

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General Services Administration: Overestimation of Federal Buildings Fund Rental Revenue Projections

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to address issues you raised about the General Services Administration's (GSA) overestimation of its rental revenue projections for the Federal Buildings Fund (FBF) in fiscal years 1996, 1997, and 1998, and the actions it is taking to improve its future revenue projections. You asked us to verify, to the extent practical, the amounts GSA has attributed to the individual reasons for the $847 million overestimation that it identified in January 1997 and determine whether GSA's corrective actions appear to us to address these reasons. (See app. I.) Also, in response to your request, we identify in this statement weaknesses that we and others found in the rental revenue estimation process used by GSA, as well as the actions it has planned or which are already under way to address them.

To verify the amount of the revenue overestimation that GSA attributed to each of the reasons it identified, we examined documents GSA had developed that explained the amount of overestimation as well as supplied supporting details, such as a listing of buildings associated with a particular problem, and we discussed each reason with GSA program officials and staff. To develop an understanding of the rental revenue estimation process used by GSA, we (1) discussed with GSA program officials and staff the basic steps involved in the process used for fiscal years 1996 through 1999, and (2) reviewed studies of the process done by an internal GSA review team, two consulting firms, and GSA's Inspector General. To determine the actions taken or planned by GSA, we interviewed relevant GSA officials and staff, reviewed documentation associated with the actions, and observed the operation of a new management information system GSA is developing to, among other things, help it estimate rental revenues.

Briefly, we found that GSA had documentation supporting the dollar amounts it attributed to six of the seven reasons it reported for the overestimation of rental revenue. In addition, we and others identified several weaknesses in GSA's rental revenue estimation process. GSA was aware of these problems and has taken corrective actions which we believe, if effectively implemented, should help improve future rental revenue estimates. Further, GSA recently reported that the actual budget impact of its rental revenue overestimation to be $634.4 million for fiscal years 1996 and 1997, and reduced its fiscal year 1998 anticipated overestimation substantially.

Background

Before proceeding further, Mr. Chairman, I would like to briefly explain the operation of FBF, which is administered by GSA's Public Buildings Service (PBS). In 1975 , FBF replaced appropriations to GSA as the primary means of financing the operating and capital costs associated with federal space owned or managed by GSA. PBS charges federal agencies rent, the receipts of which are deposited in FBF. Congress exercises control over FBF through the annual appropriations process that sets annual limits on how much of the fund can be expended for various activities. In addition, Congress may appropriate additional amounts for FBF.

The specific activities the fund is used for include space acquisition and the operation, maintenance, repair of, and improvements to, government-owned and -leased buildings managed by GSA. FBF rent revenues have grown from about $2.5 billion in fiscal year 1987 to about $4.8 billion in fiscal year 1997.

Each year, as part of the budget process, PBS calculates a revenue estimate that includes an estimate of rental revenue. Under the federal budget process, PBS' initial rental income estimate for a given fiscal year is made 18 months in advance. For example, PBS' initial rental income estimate for fiscal year 1997 was made in the spring of 1995, using rental revenue estimates for fiscal years 1995 and 1996 as a starting point. At that time, however, PBS did not yet have actual rental income data for all of fiscal year 1995, which had not yet ended, and it also did not have actual rental income data for fiscal year 1996, which had not yet begun. Accordingly, as a starting point, PBS updated and adjusted previous estimates it had made for fiscal years 1995 and 1996 based on the most recent information it had at the time, and it made assumptions about events it believed would affect rental revenues in fiscal year 1997.

Updated information PBS compiled for fiscal years 1995 and 1996 included expected (1) annualized changes in space inventories for fiscal year 1995, (2) changes in the inflation rate, and (3) changes in building delegations under which agencies pay their own building operating costs and are refunded from FBF for the operating cost portion of their rent payments. PBS obtained this information from GSA's regions and various other sources. PBS' assumptions included such factors as using a uniform national average for the number of months new space would be occupied as well as the rental rate.

Accuracy of PBS' Rental Revenue Estimates

As you can see, Mr. Chairman, forecasting rental revenues is a complex process carried out 18 months in advance that must be made with incomplete information for the 2 years preceding the year being estimated and is based on assumptions about future events. Given these circumstances, it would be reasonable to expect some differences between actual and estimated rental revenues.

In this regard, PBS' historical trends of estimated revenue versus actual revenue show actual rent revenue (1) exceeded estimated rental revenues for each year from fiscal year 1987 through fiscal year 1993—except for fiscal year 1992, when actual rental revenues were less than estimated rental revenues by 1.6 percent—and (2) differed from the estimate by less than 2 percent for each year during this period, except for fiscal year 1990, when actual revenue exceeded the estimate by 2.8 percent. However, for each of fiscal years 1994 through 1997, PBS' data showed that annual actual rental revenues were less than estimated rental revenues, ranging from an overestimate of about $110.7 million, or 2.4 percent, in fiscal year 1995, to an overestimate of about $422.1 million, or 8.2 percent, in fiscal year 1996. (See app. II.) For fiscal years 1994 and 1995, PBS overestimated rental revenues by a combined total of $308.1 million, that according to the PBS' Chief Financial Officer, was absorbed by reducing planned expenditures and using carryover balances without the need for congressional action. In addition, PBS reported a combined overestimate of $773.5 million for fiscal years 1996 and 1997, which PBS dealt with as I will explain in a moment. It is important to note that the fiscal year 1996 and 1997 overestimation from the historical analysis does not match the amount reported to Congress in January 1997 because the revenue estimates were made at different times.

In January 1997, PBS expected the total overestimation for fiscal years 1996 and 1997 to be $847 million. Subsequently, in July of 1997, PBS increased the anticipated overestimation for fiscal year 1997 by $86.8 million and reported an anticipated overestimation for fiscal year 1998 of about $109.2 million. This brought the total anticipated overestimation for fiscal years 1996 through 1998 to about $1.04 billion.

PBS took two actions to deal with the $1.04 billion anticipated overestimation. First, PBS refrained from using about $680.5 million in the spending authority provided by Congress in fiscal year 1997. Most of this spending authority was for new construction projects that PBS expected to be delayed for other reasons. Congress restored this spending authority in the fiscal year 1998 FBF appropriation. Second, PBS reduced operating

expenses in fiscal years 1997 and 1998 by deferring planned expenditures until later years to offset the remaining $359.5 million. However, after it had closed its fiscal year 1997 books, PBS reported the actual budget impact of its overestimation to be $634.4 million for fiscal years 1996 and 1997, and reduced its fiscal year 1998 overestimation to $28.3 million.

Weaknesses in PBS' Revenue Forecasting Process

As indicated, in January 1997, GSA informed Congress that it expected its total overestimate of rental revenue for fiscal years 1996 and 1997 to be $847 million. As shown in appendix I, PBS identified seven reasons for the overestimation and linked specific dollar amounts of the overestimate to each reason. For example, PBS attributed $209 million of the $847 million overestimate to rental reductions in fiscal year 1995 in 18 metropolitan areas that had not been factored into its original estimates. PBS provided documentation supporting the amount of the overestimation for six of the seven reasons. PBS could not provide data showing how the amount—$86 million—attributed to the remaining reason (i.e., that the original fiscal year 1995 rent revenue estimate was generally higher than actual fiscal year 1995 revenues) was developed. Although we examined the documentation PBS provided, we did not trace all the data compiled by PBS to explain its overestimation back to the original source documents.

In July 1997, PBS reported increased overestimates of rental revenue for fiscal years 1997 and 1998 totalling $196 million, which, if accurate, would have brought the total overestimation for fiscal years 1996 through 1998 to over $1 billion. However, PBS did not identify the causes of the increased overestimation, and in January 1998, PBS identified the actual fiscal year 1997 budget impact of the overestimate for fiscal year 1997 to be only about $14.1 million and the estimated budget impact of the revised fiscal year 1998 overestimation to be about $28.3 million, for a combined total of $42.4 million.

During the course of our work, we determined that weaknesses in PBS' estimation process contributed to the rental income overestimation. For example, while PBS reported that rent reductions in 18 metropolitan areas were not factored into the original estimates, PBS did not report why the 18 areas were omitted. Through discussions with PBS staff and review of studies done by (1) the firms of Ernst and Young and Arthur Andersen—consultants hired by GSA, (2) the GSA Inspector General, and (3) the Rent Revenue Forecasting GO Team—an internal GSA review team established to look at PBS' rental revenue estimation process—we

identified several weaknesses in the process for estimating rental revenues. These weaknesses included the following:

- Lack of documented policy and procedures for the rental revenue estimation process: In attempting to determine how the rental estimates were made for fiscal years 1996 and 1997 and the initial estimate for 1998, we found limited documentation on how the calculations were made but no documented policy, procedural steps, or guidance on the process. We had to determine the procedures and steps followed in calculating the rental revenue estimates through our discussions with PBS officials and staff. The staff who made the basic calculations for the rental estimates for fiscal years 1996 through 1998 told us they were asked to perform this work on a part-time basis because staff who had previously done the calculations had left GSA or moved on to other positions due to downsizing, reorganization, and attrition. The PBS staff members said they had no documented policies, procedures, or guidelines to follow and had learned from other PBS staff how to make the calculations. Without a documented process, however, there is less assurance that, for example, all necessary steps and information, such as consideration of rental reductions from all metropolitan areas, are factored into the estimation process or that the process is carried out consistently from year to year. Both GSA consultants, the GSA Inspector General, and the agency's GO team all found similar problems when they reviewed the process.
- Unclear lines of responsibility and accountability for revenue estimates below the level of the PBS Commissioner: Although we were able to identify PBS staff members who made the basic revenue estimate calculations, their responsibilities were not documented, nor were the responsibilities of other PBS offices and staff involved in the process. This created a lack of control over the process for estimating rental revenues. For example, one of the seven reasons for the overestimation PBS identified was an error (described by PBS as a technical error) in which $66 million was added in two different places instead of one. In our opinion, an effective review process would have caught this error, but it was not clear who in PBS was responsible for reviewing and approving calculations. A May 1997 report by the internal GSA Rent Revenue Forecasting GO team also pointed out that, while many different persons and offices provided critical input for preparing estimates, there was no clear identification of responsibility or accountability for the revenue estimates within PBS except for the PBS Commissioner.
- Lack of supporting documentation necessary to verify forecast information and assumptions: In its May 1997 report, the internal GSA GO team noted that it had to rely on the memories of, and anecdotal

information provided by, GSA employees to reconstruct the reasons for deficiencies in the rental revenue estimates. To illustrate, one of the seven reasons for the overestimation identified by PBS was a change in assumptions about costs that was made in 1995 relative to the fiscal year 1997 rent revenue estimate. For example, one assumption changed was the estimated time that increased government-owned space would be occupied in a fiscal year. The time was changed from 6 months to 9 months, which resulted in an increase in the overestimation of rental revenue. However, PBS staff said that they could not recall who had authorized the change in the assumptions. Subsequently, PBS officials advised us that responsibility for the change in the assumptions was borne by the then PBS Commissioner. We could not locate any documentation explaining why the change was made. GSA's Inspector General also noted that PBS lacked documentation for the assumptions made and methodology used to increase the revenue gap expected for fiscal year 1997.

- Use of national averages, rather than project-specific data, to forecast occupancy schedules and rental rates: For fiscal years 1996 and 1997, PBS reported that its use of national averages (which caused estimates of government-owned space increases to be too high) accounted for $142 million of the $847 million overestimation. For example, PBS assumed that it would receive rent for all space coming on line, for 9 months of the year, at the national average per square foot rental rate. In using national averages, PBS relied on less accurate data for estimating than if it had used project-specific data. In addition, in its calculations, the national average rental rate for government-owned space was changed from $40 to $44 per square foot without supporting documentation explaining the reason for the change.

Additional problems with PBS' rental revenue estimation process have also been identified. For example, in July 1997, Arthur Andersen reported that PBS lacked documentation for its budget methodology, including FBF, and had problems with its information and analysis systems as well as its pricing policies and practices.

GSA's Efforts to Improve Its Revenue Projection Process

GSA is aware of the identified weaknesses in its revenue estimation process and has corrective actions to improve this process either already under way or planned. These corrective actions include the following:

- Documentation is to be required for all decisions, assumptions, and steps involved in the rental revenue estimation process. According to a PBS

official, PBS will issue a directive on documenting the rental estimating process by April 1998. In our review of PBS' fiscal year 1999 rental revenue estimate, we found that documentation had been prepared on the decisions, assumptions, and steps involved in the process.

- Office of Financial and Information Systems (FIS), with overall responsibility for the rental revenue forecasting process, was established: In July 1997, GSA issued an order establishing FIS with one of its responsibilities being to forecast rental revenue and monitor revenue status monthly to determine whether predictions of inventory changes, other technical assumptions, and income collected are occurring as anticipated. Within FIS, there is a Rent Team, with six people (two additional positions are authorized, but not yet filled) responsible for executing these duties. In the past, forecasting revenue was treated as a part-time task, and monitoring was done quarterly. In addition, in April 1997, PBS hired a Chief Financial Officer to oversee FIS. Also, each of GSA's regions was directed to appoint a revenue manager to be responsible for this issue. According to a PBS official, as of February 20, 1998, 10 of the 11 regions have done so.
- Project-specific data is to be used in occupancy schedules and rental rates instead of national averages: In July 1996, PBS instructed each of its regions to submit monthly data on the changes expected in occupancy and rental rates for each property in its inventory. This would include known changes caused by government downsizing. However, PBS cautions that general estimates on downsizing that are not project-specific are too speculative to be used in making rental revenue forecasts. PBS intends to use project-specific data, whenever possible, to provide a more realistic fact-based estimate on which to base future rental revenues.
- New information system is being implemented to manage, track, and access data, with plans for a revenue forecasting module to be added to the system: By January 1998, PBS had installed its new information system, called the System for Tracking and Administering Real Property (STAR), in all its regions. PBS expects STAR to generate a more accurate inventory and greater integration of financial and operational data. According to PBS officials, they plan to develop a rental revenue forecast module for STAR. They expect this module to be completed by the spring of 1999 and to be used to develop the revenue projections for the fiscal year 2001 budget.

It appears that the actions PBS has under way and planned to improve its rental revenue estimation process address the weaknesses that we and others have identified. If effectively implemented, these actions should help improve future revenue estimates. However, as PBS points out, and

we agree, since its rental revenue estimate is a forecast, it is unlikely to produce an estimate that is identical to actual rental revenue. While some variance is to be expected in any estimating process, variances that go beyond a certain level can be indicative of problems that need to be addressed.

In this regard, we noted that PBS has not established an acceptable margin of error against which it can measure the success of its estimation process. Having such a benchmark, we believe, would put PBS in a better position to identify variances that need to be investigated so that it can explore and fix the causes of excessive variances, improve its estimation process, and determine its effectiveness over time.

Recommendation

We recommend that the Commissioner, PBS, establish an acceptable margin of error for its rental revenue estimates, as well as a process for exploring and resolving causes of variances outside the margin adopted.

Mr. Chairman, that concludes my prepared statement. I will be happy to answer any questions the Subcommittee may have.

PBS Reasons for the Overestimation of Revenue for Fiscal Years 1996-1998

Dollars in millions

Reason for overestimation	Amount
Less leased expansion space was delivered than was expected, and at later dates than expected.	$232
Fiscal year 1995 rental reductions in 18 metropolitan areas were not factored into the original estimates.	209
Estimates of the effect of government-owned-space increases were too high.	142
The fiscal year 1995 rental revenue estimate was generally higher than actual fiscal year 1995 revenues. Because of the timing of the budget, these high estimates were used as the basis for fiscal years 1996 and 1997 projections.	86
Assumptions concerning the costs of leased and government space were changed to make them less conservative.	82
A technical error was made in calculating the effect of indefinite authority in the rental of space.	66
Rental revenue decreases from buildings, or portions of buildings, becoming unoccupied were not factored into the original estimate.	30
Subtotal	**$847**
In July 1997, GSA increased its estimate of the fiscal year 1997 overestimation but did not identify the causes.	87
In July 1997, GSA identified an overestimation for fiscal year 1998 but did not identify the causes.	109
Total	**$1,043**

Note: PBS' $847 million overestimate was reported to Congress in January 1997 and subsequently revised downward. PBS' July 1997 overestimates were also subsequently revised downward.

Source: GSA.

FBF Estimated and Actual Rental Income for Fiscal Years 1987-1998

Dollars in millions

Fiscal year	Revenues		Percent actual is of estimated
	Estimated	Actual	
1987	$2,442.7	$2,471.7	101.2%
1988	2,921.9	2,969.1	101.6
1989	3,039.8	3,074.2	101.1
1990	3,188.2	3,278.6	102.8
1991	3,490.5	3,493.1	100.1
1992	4,001.1	3,939.0	98.4
1993	4,429.2	4,432.0	100.1
1994	4,831.2	4,633.8	95.9
1995	4,600.1	4,489.4	97.6
1996	5,117.0	4,694.9	91.8
1997	5,155.1	4,803.7	93.2
1998	4,846.1	N/A	N/A

Note 1: Rental income does not include reimbursables, outleasing, and miscellaneous income; therefore, these numbers are less than rental revenue in GSA's financial statements. This historical analysis does not match revenue overestimation reported to Congress in January 1997 because the revenue estimates were made at different times.

Note 2: N/A = Not available.

Source: GSA.

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